

Testimony to Committee for Purchase  
As presented by Brad Saathoff, VP of Operations  
BH Services, Inc., Rapid City, South Dakota  
Dallas, TX – January 19, 2006

On behalf of the Board of Directors of BH Services, Inc., a nonprofit corporation located in Rapid City, SD, we want to thank the Committee for the opportunity to comment on the questions and issues regarding nonprofit corporation qualifications and executive compensation. Our nonprofit corporation is a Community Rehabilitation Program (CRP) with contracts at Ellsworth Air Force Base, SD and Offutt Air Force Base, NE.

We agree that governance of a CRP is extremely important as the CRP must meet the scrutiny of the community in which we operate, individuals we employ, and the federal and state laws, rules, and regulations under which we operate. There already exists a tremendous amount of oversight on the operations of CRPs through the Department of Labor, IRS, and a variety of state and local agencies. There is also transparency that is required of a CRP's operation within their community. The current rules, regulations, and standards are continually being reviewed and modified by Congress, the IRS, and state agencies, and therefore how we operate is a constant challenge. In the publication Nonprofit Business Advisor, volume 8, issue 195 (December 2005), page 10, there is a survey which finds "solid oversight at most nonprofits." This can be found in attachment #1.

Due to this myriad of federal rules, regulations, and existing oversight, we feel that it is the responsibility of the Committee to select only those governance standards that you feel are most important to ensure that only qualified CRPs participate in the JWOD programs.

In regard to the Committee's desire for information and perspectives on Good Governance Practices, we have the following comments:

1. The published criteria reflect some current operating practices, but some are too specific as we note in Attachment 2, where we comment on the 14 "best practices."
2. In regard to additional criteria – we feel that the criteria for governance should primarily be based upon the requirements of the IRS and should only follow in "principle" those suggested by the Panel on the Nonprofit Sector.
3. We do not believe that national accreditation or state licensure should be a substitute for the requirements of the Committee to ensure for adherence to nonprofit agency governance practices. National accrediting bodies generally focus their reviews on various programs, services, supports, and outcomes provided to individuals with disabilities, plus other customers. They have very few standards on specific board governance. They also spend very little time in their surveys on compliance with governance practices. The standards for national accreditation vary from organization to organization and state licensing requirements also vary significantly from state to state. Even if an accredited agency's review found the corporate governance practices to be "minimal", the agency may still meet their national accrediting standards. The same holds true for state agencies providing licensing reviews as governance is only one small part of their oversight reviews. Therefore, the Committee should ask specific

programs, numbers of individuals served, other government and private fiscal resources, and accompanying rules impacting the operation of each corporation.

These variables also allow for the fact that the CEO's compensation does not directly affect the JWOD fair market prices. There are already controls on fair market prices in the contract administration and profit established by the Committee's guidelines under pricing memorandum #3. With the limit of 9½ % burden factor, the possibility of executive compensation impacting the contract is already controlled, and as long as the compensation is determined by the "rebuttable presumption of comparable salaries" as supplied by the Committee, these four items (1,2,3, & 6) are not necessary.

Number 5 questions the pay and compensation of line workers compared to highly compensated individuals. The Department of Labor establishes job classifications and prevailing wage rates for workers with consideration of knowledge, skills, and experience. These classifications therefore cannot be uniformly compared to executive positions which are not clearly defined by the Department of Labor. It would be extremely difficult to develop measurable criteria comparing management responsibilities, considering all of the economic factors and size of operations that have been previously mentioned. The increase in compensation of line workers should be a goal of the Committee in working with the Department of Labor within the Fair Labor Standards Act. They should ask for at least annual reviews of comparable salaries within each region and also to increase their fringe benefit package.

#7 – The Committee in its annual review of the participating agency could ask for a certified 990 report for nonprofits and an IRS W-2 copy from public and private for-profit agencies for their executive's compensation. There could also be certification that the information obtained from the Committee on utilizing the "rebuttable presumption of reasonableness" was reviewed.

In our Attachment 3, we would also like to comment on the definitions of terms that have been included with this notice.

We thank you for the opportunity to present our initial comments as you prepare for your proposed rule making. I am sure that after further thought and consideration by our board and staff that we will have additional comments to help the Committee ensure for good governance practices for all agencies participating in the JWOD program.

"While there will always be instances of poor governance in any sector, what this report shows is that a vast majority of nonprofit managers and governing boards take their fiscal responsibilities very seriously and have governance and accountability mechanisms in place that are far more up to the challenge than some recent accounts have suggested," said Salamon.

"This report provides some much-needed empirical evidence on how nonprofit organizations are managing their operations, and it demonstrates the inadvisability of basing wide-ranging legislation on a handful of negative anecdotes," noted **Peter Goldberg**, CEO of the **Alliance for Children and Families**, and

the chairman of the steering committee of the Listening Post Project.

We agree with Goldberg and have stated several times in the past that the sector should have promoted self-regulation rather than recommend to Congress a laundry list of legislative reforms that every organization will have to live with. ■

### For more information

The full report, *Nonprofit Governance and Accountability*, is available for downloading at [www.jhu.edu/listeningpost](http://www.jhu.edu/listeningpost).

## Payroll idea

### New wage base points out cost savers

**Y**our nonprofit and its employees will get hit with higher payroll taxes in 2006. The **Social Security Administration** announced that the maximum amount of earnings subject to the Social Security tax will increase to \$94,200 in 2006 from \$90,000 in 2005.

Using the Social Security tax rate of 6.2 percent, your employees will pay up to \$260.40 more in FICA tax in 2006. And since your nonprofit has to match this increase dollar-for-dollar, your organization's FICA tax bill will go up by the same amount. The other portion of the FICA tax is the 1.45 percent Medicare tax. However, this tax applies to all earnings — there's no cap.

#### Check your timing

One way to hold the line on Social Security taxes is to do a little year-end planning to reduce — or even eliminate — the tax bite. These ideas stem from bonus payments you plan to pay out for 2005. While the savings from the timing of one employee's bonus may be modest, they can add up quickly if it's done for several employees. And, in some cases, the savings from a single employee can be substantial.

Here are three typical situations:

**Example 1:** You pay Smith \$91,000 in salary for 2005 and she's due a \$3,000 bonus for the year. You can pay the bonus in December 2005 or in January 2006. If you pay in 2006, all of Smith's bonus will be hit by the Social Security tax. That's because even with the

bonus thrown in, Smith's 2006 wages will come to \$94,000 — short of the new \$94,200 wage base for 2006. The total tax on the bonus will come to \$372 — \$186 from your organization and \$186 from Smith.

**What to do:** Pay the bonus in 2005. Since Smith's 2005 wages have already hit the wage base, neither Smith nor your nonprofit will pay a penny of Social Security tax on her \$3,000 bonus. Of course, the organization and Smith will each pay the 1.45 percent Medicare tax. However, that would also be true if the bonus were paid in 2006.

**Example 2:** You hired Jones in July 2005 at a base salary of \$95,000, plus a generous bonus package. Despite his short time on the job, you plan to pay him a year-end bonus of \$20,000. If you pay the bonus in 2005, the entire bonus will be subject to Social Security tax. Jones and your nonprofit will owe \$2,480 in Social Security tax on the bonus (\$1,240 each). That's because even though Jones is earning \$95,000 a year — well above the wage base for 2005 — you paid him only \$47,500 for the year (his salary from July 1). So even with the bonus added in, his total compensation will fall short of the wage base for the year.

**What to do:** Pay the bonus in 2006. Since Jones will be paid his full \$95,000 salary for the year, his earnings will exceed the new wage base. Therefore, the \$20,000 bonus will be totally free of Social Security tax.

**Example 3:** Ferguson is retiring at the end of 2005. Her 2005 salary is \$100,000, and you plan to pay (See **PAYROLL** on page 12)

### **ATTACHMENT #3**

#### **Definitions:**

We strongly feel that the term "financial expert" not be required for a member of the Board of Directors. Although this definition may meet the criteria for the external CPA firm doing the annual audit, it is not feasible or practical to find such a board member in many small communities. The Board of Directors also does not audit their financial practices, but they do analyze their monthly fiscal reports and annual CPA audit. The Directors do not have an understanding of a GAAP for nonprofits, as this is special knowledge that only well-trained auditors possess. This would be a very unreasonable definition.

We would suggest the removal of #3, as this would be determined by the Board of Directors under the definition of "rebuttable presumption of reasonableness" defined under item #2.

Under #4, the definition of undue influence, we recommend the removal of the requirement for an agency's internal audit committee. Most small nonprofit agencies do not have the sufficient number of highly trained staff to conduct internal fiscal audits. Therefore, they rely on the external CPA audit to determine that they meet all of the federal requirements.